

# HOUSE BILL REPORT

## ESHB 3188

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### As Passed House:

March 10, 2004

**Title:** An act relating to liability to the department of labor and industries for premiums, overpayments, and penalties.

**Brief Description:** Concerning liability to the department of labor and industries for premiums, overpayments, and penalties.

**Sponsors:** By House Committee on Commerce & Labor (originally sponsored by Representatives Conway and Wood).

### Brief History:

#### Committee Activity:

Commerce & Labor: 2/5/04 [DPS].

#### Floor Activity:

Passed House: 3/10/04, 95-0.

### Brief Summary of Engrossed Substitute Bill

- Defines it as willful misrepresentation when industrial insurance benefits are obtained that are greater than the amount to which the person is entitled. Willful misrepresentation includes willful false statement or willful misrepresentation, omission, or concealment of a material fact.
- Increases successor liability for industrial insurance premiums owed by predecessor businesses.
- Adds a requirement to qualify for an exemption from contractor liability for industrial insurance premiums owed for work performed by subcontractors.
- Establishes corporate officer liability for certain industrial insurance premiums owed by corporations that have gone out of business.
- Authorizes the Department of Labor and Industries to use statutory collection procedures against health care providers who are overpaid.

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### HOUSE COMMITTEE ON COMMERCE & LABOR

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do

pass. Signed by 5 members: Representatives Conway, Chair; Wood, Vice Chair; Hudgins, Kenney and McCoy.

**Minority Report:** Do not pass. Signed by 4 members: Representatives McMorris, Ranking Minority Member; Condotta, Assistant Ranking Minority Member; Crouse and Holmquist.

**Staff:** Chris Cordes (786-7103); Jill Reinmuth (786-7134).

## **Background:**

### Benefit Payments to Workers

When an injured worker files a claim application with the Department of Labor and Industries (Department) or self-insurer, the worker provides certain information, including information about the injury or exposure, marital status, dependents, and employment. The application must be signed by the worker under a statement declaring the information to be true, to the worker's best knowledge and belief.

If the Department or a self-insured employer pays industrial insurance benefits that are induced by fraud, the recipient of the benefits must repay the amount with a penalty of 50 percent of the benefits. The total amount may also be recouped from future benefits. Recovered penalties are paid into the supplemental pension fund.

The industrial insurance law does not define "fraud." Instead, to prove that the payment of industrial insurance benefits have been induced by fraud, the Department must prove common law civil fraud, which is found if all of the following are shown by clear, cogent, and convincing evidence:

- the person represented an existing fact;
- the fact was material;
- the fact was false;
- the person knew that the fact was false or was ignorant of its truth;
- the person intended the Department or self-insurer to act on the fact;
- the Department or self-insurer was ignorant of the falsity of the fact;
- the Department or self-insurer relied on the truth of the representation;
- the Department or self-insurer had a right to rely on the representation; and
- the Department or self-insurer was damaged as a consequence.

If a benefit overpayment results from an appeal of a Department order where the final decision is that the payment was made because of erroneous adjudication, the claimant must repay the overpaid benefits. If benefits fail to be paid because of clerical error or other nonfraudulent mistakes, the claimant must seek an adjustment within one year of the incorrect payment. However, the claimant may not seek such an adjustment because of adjudicator errors.

### Employer Liability for Premiums

Under the Industrial Insurance Act, a person other than the employer may be liable for payment of industrial insurance premiums owed on particular work. For example, business successors, public agencies, and private entities that let contracts for work may be liable for the payment of certain premiums.

*Successor Liability.* Persons who become successors to businesses also become liable for industrial insurance premiums owed to the Department but not paid within 10 days of the sale of such businesses. "Successor" is defined as a person to whom a business sells a major part of the business's "materials, supplies, merchandise, inventory, fixtures, or equipment."

*Contractor Liability.* Many private entities that let contracts for work are liable for payment of industrial insurance premiums owed on such work. Private entities are entitled to collect the full amount payable to the Accident Fund from the contractor, and the contractor is entitled to collect from a subcontractor a proportionate amount of that. Consequently, the person letting the contract functions as a surety for the industrial insurance premiums.

The Washington Court of Appeals has described these provisions as "facilitat[ing] and broaden[ing] the premium collection powers of the Department." The Court of Appeals also said that the rationale for giving the Department these collection powers is that "the more the [Industrial Insurance Act] facilitates full collection of premiums, the better it serves the accident fund from which compensation is paid."

However, if certain requirements are satisfied, registered contractors and licensed electrical contractors are not liable for premiums owed on a subcontractor's work. These requirements are as follows:

- The subcontractor is a registered contractor or a licensed electrical contractor;
- The subcontractor has a principal place of business that is eligible for a business deduction for IRS purposes;
- The subcontractor maintains separate records reflecting business income and expenses; and
- The subcontractor contracted to perform certain types of work, such as construction, alteration, or demolition of a structure, or electrical work.

*Corporate Officer Liability.* Generally, corporate officers and other individuals are not personally liable for premiums owed by corporations or limited liability companies.

### Collection of Provider Overpayments

The Department is authorized to conduct audits of health services providers, including medical, chiropractic, dental, vocational, and other providers of services to injured workers. In these audits, the Department may examine records relating to services rendered to an injured worker that were reimbursed by the Department.

If a provider unintentionally receives reimbursement to which he or she was not entitled, the provider is required to repay the excess amount, plus interest. If the provider knowingly receives an overpayment because of willful false statement, willful misrepresentation of a material fact, or another fraudulent scheme, the provider must repay the excess amount, plus interest, and civil penalties of up to \$1,000 or three times the amount of the overpayment, whichever is greater. The provider is also subject to a class C felony, with a fine of up to \$25,000, for certain "knowing" violations. Civil penalties are deposited in the State General Fund.

To collect overpaid benefits from workers or unpaid premiums from employers, the Department, or self-insured employer in the case of overpaid benefits, is permitted to obtain a warrant in superior court on a final Department order. The warrant is treated like a judgment and becomes a lien on the property of the person named. The warrant may be executed in the same manner as other court judgments. This statutory collection authority does not apply to providers who fail to repay overpayments or penalties.

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### **Summary of Engrossed Substitute Bill:**

#### Benefit Payments to Workers

**Willful Misrepresentation.** It is willful misrepresentation for a person to obtain industrial insurance payments or benefits that are more than the amount to which he or she is otherwise entitled. Willful misrepresentation includes:

- willful false statements; or
- willful misrepresentation, omission, or concealment of a material fact.

A "material fact" is one that would result in additional, increased, or continued benefits, including facts about physical restrictions, or work-type activities that result or would reasonably be expected to result in wages or income. For a work-type activity to be reasonably expected to result in wages or income, a pattern of repeated activity must exist. The Department is authorized to impute wages when wage information cannot be reasonably determined for activities that would reasonably be expected to result in wages or income.

"Willful" means a conscious or deliberate false statement, misrepresentation, omission, or concealment of a material fact with the specific intent of obtaining, continuing, or increasing benefits. Failure to disclose a work-type activity must be willful for a misrepresentation to have occurred.

These new provisions apply to willful misrepresentation determinations issued on or after July 1, 2004.

**Adjudicator Error.** If benefits are overpaid because of adjudicator error, the Department may only assess an overpayment when the order on which the overpayment is based is not yet final, unless the overpayment relates to an order rejecting the claim, results from a final appeal of a Department or Board of Industrial Appeals order, or has been induced by willful misrepresentation. If benefits fail to be paid because of adjudicator error, the claimant must address the adjustment by filing a written request for reconsideration or an appeal within the statutory sixty-day appeal period.

#### Employer Liability for Premiums

The provisions of the Industrial Insurance Act relating to successor and contractor liability are modified. A provision relating to corporate officer liability is added.

**Successor Liability.** The definition of "successor" is modified. Instead of being restricted to a person to whom a business sells a major part of the business's "materials, supplies, merchandise, inventory, fixtures, or equipment," a successor is a person to whom a business sells the business's property, "whether real or personal, tangible or intangible."

**Contractor Liability.** The requirements that must be satisfied for registered contractors and licensed electrical contractors to be not liable for subcontractor premiums are modified. In addition to current statutory requirements, a subcontractor that is an employer must have an industrial insurance account in good standing or be a self-insurer when the subcontract is let. A contractor may consider a subcontractor's account to be in good standing if: (1) The contractor verifies that the account is in good standing within a year prior to letting the contractor and at least once a year thereafter; and (2) the contractor does not receive written notice that the account status has changed.

**Corporate Officer Liability.** When a corporate or limited liability company goes out of business, corporate officers and other persons are personally liable for premiums owed by the businesses, and any interest and penalties on the premiums, if: (1) The officers or other persons willfully failed to pay the premiums; and (2) the premiums became due while the officers or other persons were responsible for their payment.

Corporate officers and other persons are not liable, however, if they are subject to mandatory coverage and were directed to pay premiums by a person who is exempt from mandatory coverage.

"Willfully fails to pay or to cause to be paid" is defined as meaning a failure that was the result of "an intentional, conscious, and voluntary course of action."

Taxpayer Education. The Department, when practical, must publish information and provide training to promote understanding of potential premium liability.

#### Collection of Provider Overpayments

The Department or self-insured employer is authorized to pursue the collection of unpaid overpayments, penalties, and interest from health care providers using the same procedures that are used to collect overpayments from workers.

#### Rule Adoption

The Department must adopt rules to implement the bill.

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**Appropriation:** None.

**Fiscal Note:** Not requested.

**Effective Date:** The bill takes effect 90 days after adjournment of session in which bill is passed.

**Testimony For:** (Presented on HB 3058, relating to benefit fraud) The definition of fraud used by the courts for industrial insurance cases requires proof of nine separate elements, which makes it very difficult to prove in some cases. For example, a self-employed person was found to be not committing fraud while collecting benefits because the business was not making a profit. The bill would put into law a definition of fraud that relies on willful false statements or concealing a material fact. This will be similar to the fraud criteria for employers and providers. This and the other agency request bills addressing fraud issues need to move together as a package. These changes are needed to improve the industrial insurance system's integrity. While the changes may not result in large savings, it will give security to those who pay into the system.

(With concerns, presented on HB 3058, relating to benefit fraud) With some changes, there could be agreement on the Department's entire fraud package. The definitions of "willful" and "material" must be very clear. The person must be knowingly lying and the material fact must be one that really impacts the Department's adjudication of the claim. There is a need to correct a provision of the law dealing with recoupment of overpaid benefits.

(Presented on HB 3059, relating to liability for industrial insurance premiums) This bill addresses employer abuses. It changes the definition of successor so that transfers of intangible assets, like address lists, are covered. This language is similar to language in last year's bill defining successor for purposes of the state sales tax. It also specifies that corporate officers can be held responsible if they willfully failed to pay premiums. This

language is also similar to language in other state and federal laws. It establishes additional requirements for registered contractors and electrical contracts. Their subcontractors must have an account in good standing when their contract was let. This gives us some insurance that the subcontractor is a viable entity.

This bill will help deal with the underground economy. Right now, contractors who are not licensed, not bonded, and not insured fail to pay their employee and their taxes. When one of their workers gets hurt, the worker is covered, but all of us bear the cost. This will help keep contractors on a level playing field. We can't ignore the problem of cheaters. This bill is the culmination of work by business and labor.

We support the intent and/or the goals of these bills. We have some logistical concerns about verification of premium payment status. This could be difficult for contractors that use hundreds of subcontractors, as well as for those that lack internet access. We also have some concerns about corporate officer liability.

The definition of "successor" should be the same as in other state laws. The Department of Labor and Industries, and Employment Security Department, and the Department of Revenue should all use one definition. Either they are successors or they aren't.

The corporate officer liability section is of some concern. It may overreach and cover someone with control and supervision even though the chief executive officer may have directed that person to pay or not pay the premiums.

(Presented on HB 3060, relating to collection of provider overpayments) In some cases, providers who have been ordered to repay the Department or an injured worker, or who have agreed to a settlement of an overpayment claim, have refused to pay the Department or worker. The Department does not have authority to collect these overpayments using property liens as it does when collecting moneys owed from claimants and employers.

**Testimony Against:** (Presented on HB 3058, relating to benefit fraud) While no one approves of fraud, this bill does not protect workers' due process rights. The nine elements used to prove fraud have evolved over the years and require very accurate and thorough proof. This is appropriate for a penalty that is akin to calling the perpetrator a thief. The new test would not require a reasonable person standard, any showing of intent to deceive, any showing of reliance by the Department on the statements made, and other elements. It is not clear why income could not have been imputed in the example given by the Department. Workers who have been accused of fraud carry the stigma for a long time. Even after a fraud charge is overturned, the worker may have a hard time recovering from the harm caused. Fighting the case is very expensive. The Department should not be given more latitude to make fraud accusations.

**Persons Testifying:** (In support of HB 3058, relating to benefit fraud) Representative McCoy, prime sponsor; Paul Trause, Department of Labor and Industries; Amber Balch

Carter, Association of Washington Business; Mark Johnson, National Federation of Independent Business.

(With concerns on HB 3058, relating to benefit fraud) Robby Stern, Washington State Labor Council.

(Opposed to HB 3058, relating to benefit fraud) Wayne Lieb, Washington State Trial Lawyers Association; Snyder Klusman; and Richard Smith.

(In support of HB 3059, relating to liability for industrial insurance premiums) Paul Trause, Department of Labor and Industries; Robby Stern, Washington State Labor Council; Jeff Kelley, International Union of Painters & Allied Trades; Amber Balch Carter, Association of Washington Business; Dick Mettler, Northwest Wall and Ceiling Contractor Association; Gary Smith, Independent Business Association; Mark Johnson, National Federation of Independent Business; and Rick Slunaker, Associated General Contractors of Washington.

(With concerns on HB 3059, relating to liability for industrial insurance premiums) Amy Brackenbury, Building Industry Association of Washington.

(In support of HB 3060, relating to collection of provider overpayments) Representative Kenney, prime sponsor; Paul Trause, Department of Labor and Industries; and Amber Balch Carter, Association of Washington Business.

(With concerns on HB 3060, relating to collection of provider overpayments) Cliff Webster, Washington State Medical Association.

**Persons Signed In To Testify But Not Testifying:** None.